STATE TAX COMMISSION

In the Matter of Petition

of

GENERAL SIGNAL CORPORATION

for refund of franchise tax under Article 9-A of the tax law for 1968

General Signal Corporation having filed a petition for refund under Article 9-A of the tax law for 1968, and a hearing having been held at the office of the State Tax Commission, State Campus, Albany, New York, at which hearing E. Kantor, Director of Taxes of the corporation, and K. R. Parker, Certified Public Accountant, appeared and the record having been duly examined and considered by the State Tax Commission,

It is hereby found:

- (1) The corporation filed a franchise tax return for 1968 adding back to Federal taxable income \$5,293,948 representing capital stock investment in and notes receivable arising from loans to its wholly owned subsidiary, Avion Electronics, Inc., ("Avion"). This amount was considered worthless and had been taken as a deduction in arriving at Federal taxable income. The amount was added back by the taxpayer on form CT-3 at Schedule B, Item 4.
- (2) Subsequently, the taxpayer filed a claim for refund and amended return for 1968 adding back only \$1,833,855, which represented the worthless capital stock investment in Avion.
- (3) Avion (now P.A.E.I.Co.) was incorporated in Delaware on February 23, 1966 and was engaged in the manufacture of electronics. It filed New York State franchise tax returns under Article 9-A for the years 1966 through 1970. Its return for 1968 reflected interest of \$200,801 to its parent, of which 90% or \$180,721 was added back by Avion on form CT-3 at Schedule B, Item 3.

Federal taxable loss of \$4,311,167 was reported at Item 1.

General Signal Corporation treated the interest income from Avion as business income on its original return for 1968 and as investment income on its amended return for that year.

- (4) Based on a field audit examination conducted by its Buffalo District office on Avion and General Signal Corporation, the Corporation Tax Bureau determined that Avion was not subject to New York State franchise tax. Credits were issued to that corporation for the taxes paid for the years 1966 through 1970, and applied against added taxes asserted against General Signal Corporation.
- \$3,459,394 worthless notes receivable from Avion was not a proper deduction in computing entire net income of General Signal Corporation. Based on the field audit examination, a statement of tax reduction was issued for 1968 indicating an overassessment of tax in the amount of \$18,316.00, which was applied as a credit against a notice of deficiency for 1969. The only item in dispute is the disallowance of the deduction of \$3,459,394.
 - (6) Section 208 of the tax law reads in part:
 - "3. The term 'subsidiary' means a corporation of which over fifty per centum of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer;
 - "4. The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries . . . on which interest is not claimed and deducted by the subsidiary for purposes of taxation under articles nine-a, nine-b, or nine-c . . ."

Section 208.9 of the tax law reads in part:

"(a) Ehtire net income shall not include: "(l) Income, gains and losses from subsidiary capital . . . "

The State Tax Commission hereby DECIDES:

- (A) The election in Section 208.4 is applicable only in those cases where the subsidiary is subject to New York State franchise tax and files a return claiming a deduction for interest paid to its parent. Since Avion was not taxable, it could not make a valid election. The amount of \$3,459,394 representing worthless notes receivable from Avion is therefore subsidiary capital, and a deduction for such loss cannot be claimed pursuant to Section 208.9(a)(1) of the tax law.
- (B) The credit for overassessment of \$18,316.00 indicated in (5) is affirmed and taxpayer's petition for a larger credit is denied.

Dated: Albany, New York
this 24th day of October 1974.

STATE TAX COMMISSION

President

Commissioner

Commissioner